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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 333

ELAINE YAGODA (Formerly Elaine Drechsler), et al.,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 19a-45a)[1] are reported at 39 T.C. 170. The opinion of the Court of Appeals (Pet. 4a-17a) is reported at 331 F. 2d 485.

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[1] "R." references are to the Appendix to the petitioners' brief in the Court of Appeals. "Supp. R." reference is to Appendix B to the Commissioner's brief.

JURISDICTION

The judgment of the Court of Appeals was entered on May 1, 1964. (Pet. 4a.) The petition for a writ of certiorari was filed on July 29, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below correctly sustained the Commissioner's assessment of income tax deficiencies for otherwise barred years under the mitigation of limitations provisions of Sections 1311-1314 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

The pertinent portions of Section 275 of the Internal Revenue Code of 1939 and Sections 1311, 1312, 1313, and 1314 of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*, pp. 11-15.

STATEMENT

In 1944, Gus Drechsler transferred most of his 60% interest in a partnership (the T. F. Jackson Company) to two irrevocable trusts, one for the benefit of his wife, Lena, the other in favor of his daughter, Elaine. Gus and the two trusts each reported their proportionate shares of the partnership income in their respective returns for 1944. In 1945, Lena Drechsler terminated the trust for her benefit and became a partner in her own right. For 1945, Gus, Lena, and the Elaine trust reported their propor-

tionate shares of the partnership income in their respective returns. (R. 20a-22a; Pet. 6a.)

The Commissioner refused to recognize the two trusts and Lena as bona fide partners during 1944 and 1945 and treated their respective shares of the partnership income as income to Gus. The deficiencies assessed against Gus for those years were paid in part by crediting to him the proposed over-assessments in favor of the trusts and Lena Drechsler resulting from their tax payments on account of the partnership income allocated to them. Lena Drechsler, as executrix of the estate of Gus Drechsler (who had died in January, 1946), filed claims for refund, asserting that Gus was wrongly charged with all of the family's income from the partnership in 1944 and 1945. When the claims were rejected a refund suit was instituted in the District Court for the Southern District of New York. The court sustained the claimed overpayment and on April 30, 1958, entered judgment for the plaintiff which required refund of taxes attributable in part to partnership income properly taxable to the trusts and Lena. (R. 24a-26a; Pet. 6a-7a.)

The judgment of the district court became final on September 19, 1958, and on June 5, 1959, notices of deficiencies were sent to the petitioners in this suit with respect to the partnership income for 1944 and 1945 which had escaped tax. (R. 26a-27a; Pet. 7a-8a)

The Tax Court held that, as a result of the district court judgment in 1958 (adopting the contentions

made on behalf of Gus Drechsler), there was a double exclusion of partnership income properly taxable to the two trusts and Lena Drechsler, individually, for 1944 and 1945, and that, pursuant to Sections 1311-1314 of the Internal Revenue Code of 1954, the Commissioner's notices of deficiencies for those years were timely. (R. 31a-42a.) The Tax Court also held that Lena Drechsler is not liable as transferee of the trust for her benefit with respect to the trust's 1944 liability, but that Elaine Yagoda is liable as transferee of the trust for her benefit to the extent of $7,994.39 with respect to that trust's 1944 and 1945 liability. (R. 42a-45a.) The Court of Appeals affirmed the decisions of the Tax Court.

ARGUMENT

Sections 1311-1314 of the Internal Revenue Code of 1954, Appendix, *infra*, pp. 11-15, provide that, under specified circumstances, where an error has been made in the inclusion or exclusion of income or in the allowance or disallowance of a deduction or in the tax treatment of a transaction affecting the basis of property, the error may be corrected even though the ordinary period of limitations has run.[2] So far

[2] The purpose of these sections is remedial, not punitive, and the courts have generally interpreted the provisions realistically to carry out this purpose. *Cory* v. *Commissioner*, 261 F. 2d 702, 704 (C.A. 2d), certiorari denied, 359 U.S. 966; *Gooch Milling & Elevator Co.* v. *United States*, 78 F. Supp. 94 (Ct. Cl.); *H. T. Hackney Co.* v. *United States*, 78 F. Supp. 101 (Ct. Cl.); *United States* v. *Rosenberger*, 235 F. 2d 69 (C.A. 8th); *Olin Mathieson Chemical Corp.* v. *United States*, 265 F. 2d 293 (C.A. 7th); *United States* v. *Rachal*, 312 F. 2d 376 (C.A. 5th).

as relevant here, those provisions allow correction of an error in a barred year when a "determination" has been made for an open year treating an item of income inconsistently with the way it was treated in the income of a "related taxpayer" in the barred year. It is not disputed here that there was a "determination" (the district court holding in 1958) which required the exclusion from Gus Drechsler's gross income of partnership income erroneously excluded from the gross incomes of the two trusts and Lena Drechsler. Nor is it challenged that this determination adopted a position maintained by and on behalf of Gus Drechsler which was inconsistent with the erroneous exclusions. And it is conceded that the trusts and Lena, as partners of Gus Drechsler, were "related taxpayers" at least at the time his tax return for 1944 was filed, wherein the adopted position was first maintained. In the circumstances, it appears that each of the requirements for application of the mitigation provisions was met, and that the Commissioner's notices of deficiencies within one year from the date of the determination were timely.[3]

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[3] Petitioners contend that Sections 1311-1314 were not meant to apply in circumstances where, as here, the Commissioner had an opportunity (upon learning that a refund claim had been filed on behalf of Gus Drechsler) to protect his position with regard to the trusts and Lena prior to the running of the statute of limitations. (Pet. 7-8.) However, as the Tax Court said (R. 40a-41a, quoted by the Court of Appeals at Pet. 14a):

> While the mitigation provisions might have been formulated in terms of the Commissioner's or the taxpayer's ability to correct the error when the inconsistency involved was first brought to his attention, they were not

Petitioners assert, however, that the inconsistent position requirements of subsections (b)(1) and (b)(3) of Section 1311 have not been satisfied. With respect to Section 1311(b)(1), they argue that neither they, nor Gus Drechsler, ever changed position or took a position inconsistent with that of the other partners. (Pet. 8, 9). But that is not the test under the statute. Section 1311(b) merely requires that "there [be] adopted in the determination [here the district court judgment] a position maintained by the taxpayer with respect to whom the determination is made [Gus Drechsler] [which] is inconsistent with the erroneous * * * exclusion [of their shares of the partnership income in the treatment of the related taxpayers]." It is irrelevant that the erroneous exclusion from petitioners' taxable income is attributable to the Commissioner.[4] Nor does it matter that

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so written. Instead, all that the provisions of Sections 1311-1314 require is that correction of the error is prevented by the operation of any law or rule of law when the *determination* becomes final (Sections 1311(a) and 1313(a)(1)) and that the notice of deficiency or claim for refund making the correcting adjustment be sent within one year after such determination becomes final (Section 1314(b)). These conditions were met in the present cases.

[4] Petitioners refer to the example set out in Treasury Regulations on Income Tax (1954 Code), Section 1.1311(b)-1(c)(2) (26 C.F.R., Sec. 1.1311(b)-1(c)(2)). This example presents the situation in which the Commissioner voluntarily proposes the allowance of a deduction which had already been allowed for a prior year. In this situation, when a court orders the allowance of the deduction, there has been no inconsistent position "maintained" by the taxpayer which is

the trusts and Lena Drechsler originally reported their proper shares of the partnership income. Those items were later removed from their incomes[5] and the subsequent determination with respect to Gus, maintaining his position, produced an inconsistency resulting in a double exclusion of income. The statute requires no more.[6] In so holding the courts below are in accord with the other authorities which have considered this problem. See *Albert W. Priest Trust* v. *Commissioner*, 6 T.C. 221, 226; *Ross* v. *United States*, 148 F. Supp. 330 (D. Mass.); *Estate of*

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adopted in the determination. Here, the position inconsistent with the erroneous exclusion of income items from the gross incomes of the trusts and Lena was maintained by and on behalf of Gus Drechsler and was adopted in the district court judgment. This is the inconsistent position about which the statute speaks.

[5] Petitioners argue that they did not receive the tax refunds resulting from the removal of the partnership shares from their incomes. (Pet. 11.) However, the courts below properly inferred the approval of Lena Drechsler as trustee and on her own behalf for the crediting of any overassessments to Gus Drechsler's tax deficiencies. (Pet. 10a) And the amounts so credited were part of the refund to Gus Drechsler's estate as ordered by the District Court. (Supp. R. 5.)

[6] See Mullock, *The Inconsistent Position: Section 1311(b)(1)*, 12 Mercer L. Rev. 300, 307 (1961):

> Inconsistency, then, is ascertained by reference to what was actually done in the earlier year rather than to what the taxpayer or the Commissioner may have urged at the time. Nor is it limited to change of position. An unconscionable advantage and misuse of the statute of limitations may obtain just as readily without change of position where the beneficiary of the statutory bar persists in his error or "snaps up" an error, persistent or otherwise, of the opposite party.

Weinreich v. *Commissioner*, 37 T.C. 365, reversed on other grounds, 316 F. 2d 97 (C.A. 9th); *United States* v. *Rushlight*, 291 F. 2d 508, 518 (C.A. 9th); Maguire, Surrey and Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 509, 719, 735 (1939); Plumb, *The Problem of Related Taxpayers: A Procedural Study*, 66 Harv. L. Rev. 225, 256 (1952); Mullock, *supra*.

Section 1311(b)(3) provides that an adjustment under the mitigation provisions is not to be made with respect to a related taxpayer "unless he stands in such relationship to the [principal] taxpayer at the time * * * [the principal taxpayer] first maintains the inconsistent position in a return * * * [or] claim for refund * * * for the taxable year with respect to which the determination * * * [was] made * * *."

In this case the partnership relationship was still in existence when Gus Drechsler's returns were filed for 1944 and 1945,[7] and in those returns the position which was later adopted in the determination was first taken. The Court of Appeals agreed with the Tax Court that Section 1311(b)(3) requires only that the taxpayers be related when the successful position is first maintained, not when the inconsistency first occurs. Accord: *Ross* v. *United States*, *supra*; Plumb, *The Problem of Related Taxpayers:*

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[7] This conclusion as to the existence of the partnership was concurred in by the two lower courts and is entitled to finality in the absence of a very exceptional showing of error. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

A Procedural Study, 66 Harv. L. Rev. 225, 255-256 (1952); Cohen, *Related Party Provisions of Sections 1311-1315*, 22 N.Y.U. Tax Institute (1964), pp. 411, 427-428.

It is true that in *Commissioner* v. *Estate of Weinreich*, 316 F. 2d 97, the Court of Appeals for the Ninth Circuit, as an alternative ground for decision, reversed the Tax Court on this point, holding that the "inconsistent position" refers to a position of related taxpayers "at that time in existence." 316 F. 2d at 105. Under this view the inconsistent position in the instant case was first taken when the claims for refund were filed on behalf of Gus Drechsler, after there was an erroneous exclusion from the gross incomes of the two trusts and Lena Drechsler. But the *Weinreich* rule unduly restricts the scope of Section 1311(b)(3) by reading into it an additional condition which the text does not justify. The court below was fully warranted in rejecting the authority of that case and following the courts other than the Ninth Circuit which have had the question before them as well as the opinions of those commentators who have considered the point.

Although taxpayers disagree with the decision below on several grounds, the only direct conflict is with the decision of the Ninth Circuit on the issue as to when the relationship must exist. The mitigation statute is a complex and technical group of sections which has only a limited applicability. Questions as to the minor provision here in question have seldom arisen. We submit that the issue has not yet proven to be of such importance or to occur with

such frequency as to require resolution by this Court at the present time.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SEPTEMBER, 1964.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * *

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 1311. CORRECTION OF ERROR.

(a) *General Rule.*—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) *Conditions Necessary for Adjustment.*—

(1) *Maintenance of an inconsistent position.*—Except in cases described in paragraphs (3)(P) and (4) of section 1312, an

adjustment shall be made under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his delegate, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made,

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

* * * *

(3) *Existence of relationship.*—In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B)), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the

United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

SEC. 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

* * * * *

(3) *Double exclusion of an item of gross income.*—

(A) *Items included in income.*—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or

(B) *Items not included in income.*—The determination requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

* * * * *

SEC. 1313. DEFINITIONS.

(a) *Determination.*—For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment decree, or other order by any court of competent jurisdiction, which has become final;

* * * *

(c) *Related Taxpayer.*—For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

(1) husband and wife,
(2) grantor and fiduciary,
(3) grantor and beneficiary,
(4) fiduciary and beneficiary, legatee, or heir,
(5) decedent and decedent's estate,
(6) partner, or
(7) member of an affiliated group of corporations (as defined in section 1504).

SEC. 1314. AMOUNT AND METHOD OF ADJUSTMENT.

* * * *

(b) *Method of Adjustment.*—The adjustment authorized in section 1311(a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with re-

spect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss arises.

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